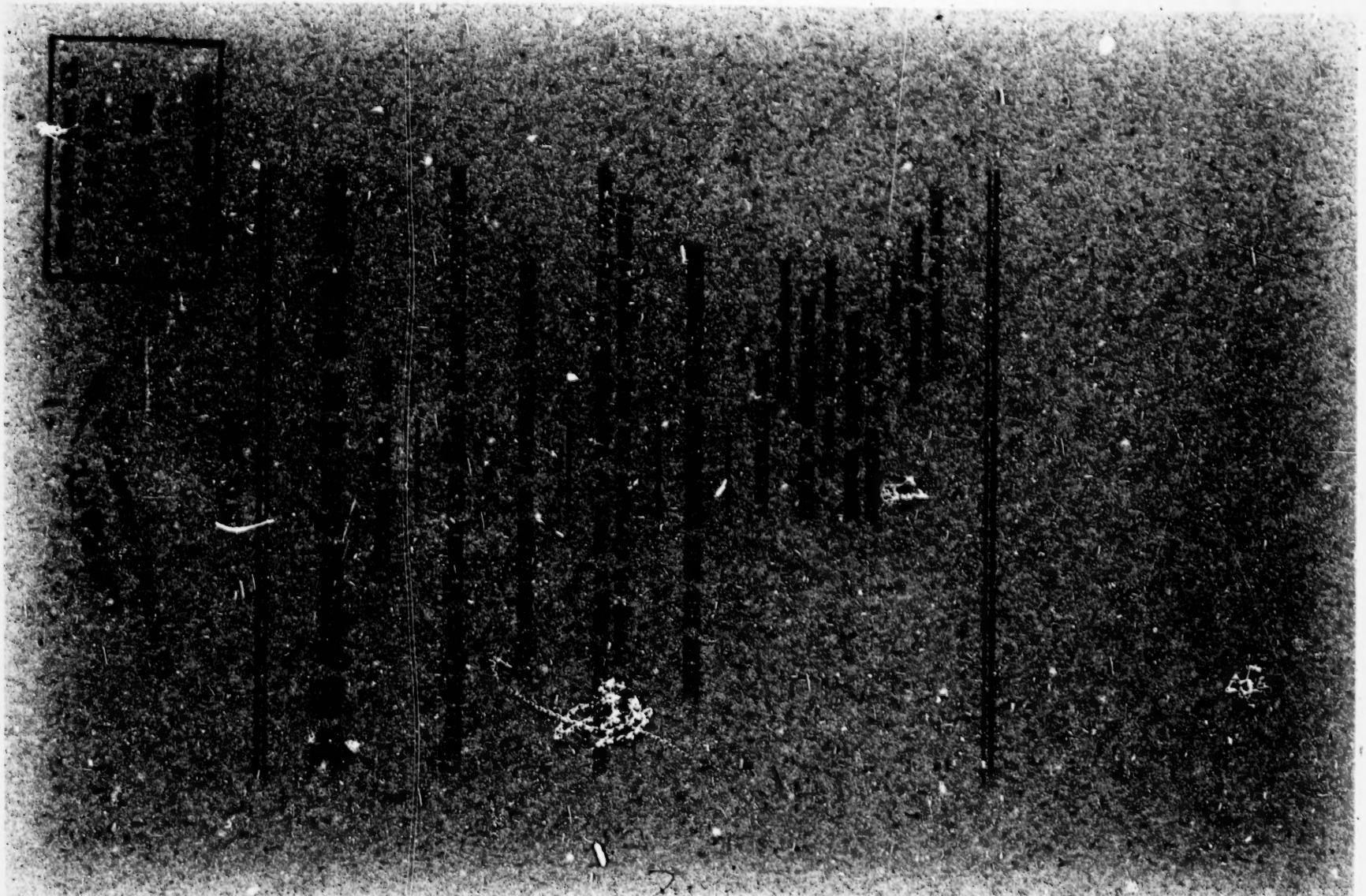

In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 186

CHARLES ORAN MENSIK AND MARY MENSIK, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. 1a–8a) is reported at 328 F. 2d 147. The opinion of the Tax Court (R. 30–113)[1] is reported at 37 T.C. 703.

JURISDICTION

The judgment of the court of appeals was entered February 10, 1964 (Pet. 9a), and a petition for rehearing was denied on March 17, 1964 (Pet. 10a). The petition for a writ of certiorari was filed on June 15, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

[1] "R." refers to the appendix to petitioners' brief in the court of appeals. "Tr." refers to the original transcript of the record in the Tax Court, which has been filed with the Clerk of this Court.

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QUESTIONS PRESENTED

1. Whether the Tax Court correctly concluded that petitioner[*] had received taxable income in 1956 as a result of overpayments for services made between corporations controlled by petitioner and subsequent "loans" to petitioner's associate.

2. Whether the Tax Court correctly concluded that at least part of the tax deficiency was due to fraud with intent to evade tax so as to warrant imposition of a fraud penalty.

3. Whether the fraud penalty was properly assessed against both petitioner and his wife, who filed joint returns.

4. Whether the Tax Court properly denied petitioner's request for rehearing.

STATUTE AND OTHER AUTHORITIES INVOLVED

Internal Revenue Code of 1954:

> SEC. 61. GROSS INCOME DEFINED.
>
> (a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
>
> (1) Compensation for services, including fees, commissions, and similar items;
>
> (2) Gross income derived from business;
>
> (3) Gains derived from dealings in property;
>
> * * * * *
>
> (26 U.S.C. 1958 ed., Sec. 61.)

[*] For the sake of convenience, C. Oran Mensik is referred to as "petitioner," although his wife, Mary Mensik, is also a petitioner by reason of having filed a joint return with her husband for the 1956 tax year.

SEC. 6653. FAILURE TO PAY TAX.

(a) *Negligence or Intentional Disregard of Rules and Regulations With Respect to Income or Gift Taxes.*—

* * * * * *

(b) *Fraud.*—If any part of any underpayment (as defined in subsection (c)) of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment. In the case of income taxes and gift taxes, this amount shall be in lieu of any amount determined under subsection (a).

* * * * * *

(26 U.S.C. 1958 ed., Sec. 6653.)

STATEMENT

The facts are set forth in detail in the findings of fact of the Tax Court (R. 30-66). The pertinent portions thereof may be summarized as follows:

During 1956, petitioner controlled several corporations, including City Savings Association, a mutual savings and loan association, of which he was managing officer, president, and chairman of the board of directors. He also had control over Melvin Building Corporation [hereinafter "Melvin"]. Although no Melvin stock was issued in his name, petitioner's relatives and other associates, who nominally held the stock, took instructions from petitioner regarding the conduct of Melvin's business (R. 35-39, 82).

Melvin was in the real-estate and construction business, and all of its construction work in 1956 was financed either by City Savings or by some other financial institution controlled by petitioner. From

September 1955 to March 1956, Melvin remodeled the City Savings Building. Petitioner instructed Melvin's accountant to add additional fictitious costs to the remodeling job and to alter the records so as to reflect the total cost to Melvin as $256,207.26, instead of an actual cost of $115,397.71. City Savings then paid Melvin $367,800 (R. 36, 39–40, 43–44).

Orville Hodge, Auditor of Public Accounts of the State of Illinois, issued charters to some of the financial institutions controlled by petitioner and retroactively approved the investment of 10 to 15 percent of these institutions' assets in their own buildings, under a provision of Illinois law which requires any such investment in excess of 5 percent to be approved by the auditor. On May 11, 1956, City Savings loaned $200,000 to Hodge, secured by a mortgage on certain property in Fort Lauderdale, Florida. At petitioner's request, Melvin transmitted $76,312.50 to Hodge on March 12, 1956, for which Hodge executed an unsecured 90-day judgment note. Petitioner represented to Melvin that the "loan" would be repaid from the proceeds of the City Savings mortgage. On June 29, 1956, Melvin issued two more checks for $50,000 each, for the purpose of lending $100,000 more to Hodge. One check was made payable to cash, and the currency was delivered to petitioner. The other check was made payable to City Savings and was endorsed by it. Two more unsecured judgment notes in the amount of $50,000 each, bearing no due date, were executed by Hodge on June 29, 1956. Hodge, who was shortly thereafter charged with embezzling State funds and was subsequently convicted, never

repaid either the $76,312.50 or the $100,000 "loan" (R. 44, 46–48).

On July 17, 1956, two days after Hodge was charged with embezzlement, petitioner borrowed $200,000 from Melvin to buy the mortgage on the Fort Lauderdale property from City Savings. Petitioner then gave Melvin a five-year judgment note for $200,000, payable at four percent.

On the basis of these transactions and others which are not relevant here, the Commissioner of Internal Revenue entered a deficiency jeopardy assessment for 1956 in the amount of $547,967.55, plus a fraud penalty of $273,983.78 (R. 64). The Tax Court found a deficiency of $201,022.33,[1] and held that part of the deficiency was due to fraud with intent to evade. Hence it concluded that a 50 percent addition to tax was warranted (R. 1). Petitioner filed a motion for rehearing (Tr. 975–988; R. 113–122, 127–131) which the Tax Court denied (Tr. 1039).

The Court of Appeals affirmed the Tax Court (Pet. 7a.) Both courts found that overpayment of City Savings funds to Melvin, under the guise of pay-

[1] In this Court, petitioner apparently challenges only the validity of the Tax Court's finding with respect to the $176,312.50 "loaned" to Hodge. The other seven findings (R. 31–33) are not challenged.

[2] The Tax Court permitted the Commissioner to amend his answer (Tr. 115; R. 26–27), in which he asserted (Tr. 116; R. 27–28) that one item of unreported income, originally determined to be $176,312.50 (R. 65), relating to petitioner's omission of income from City Savings, should have been $376,312.50. The Tax Court, however, sustained the original determination as to this item, and the Commissioner did not appeal from that decision.

ments for the remodeling of the City Savings Association Building, was advisedly arranged by petitioner, and that part, if not all, of the overpayment was thereafter paid by Melvin to petitioner and to Hodge on petitioner's behalf. (R. 55, 66-95.)

ARGUMENT

This case involves only the resolution of factual issues regarding petitioner's transactions in 1956. Both courts below resolved these issues against petitioner. There is no conflict in decisions, and no question of general importance is presented by this case.

1. The deficiency of $76,312.50, which petitioner challenges, represents overpayments made by City Savings to Melvin on the remodeling contract, which ultimately were paid to Hodge, in the guise of loans, on petitioner's instructions. The evidence demonstrated that the original estimate for the job was $125,000, that the actual total cost was $115,297.71, and that Melvin was paid $337,800. (Tr. 563-569, 699-700, 737-738; R. 10-11; Ex. V.) Petitioner directed that false entries be made in Melvin's books to conceal the true profit and to overstate the actual costs. (Tr. 384-387, 491-493, 570-574, 609-611, 622-626, 724-736; Exs. S, V.)

The receipts, funds were funneled from Melvin on petitioner's instructions. As the Tax Court observed, it was not coincidental that the $76,312.50 "loan" to Hodge was consummated shortly after payments were made from City Savings to Melvin in the amounts of $45,000 and $61,000. And the two $50,000 checks representing a "loan" to Hodge on June 29, 1956, in amounts actually received in cash by petitioner—closely

followed payments of $46,800 and $43,000 on the remodeling job.

The Tax Court was, therefore, fully warranted in concluding that the payments to Hodge were actually "made for the account of petitioner" and that he, not Melvin, was to "be the ultimate recipient" (R. 111-112). Petitioner's contentions (Pet. 11-15) that he realized only Hodge's "favors" as a result of these transactions and that he personally received no part of these "loans" misapprehend the basis of the Tax Court's findings. It is because petitioner fully controlled the disposition of the overpayments made to Melvin that such amount was taxable to him. See, *e.g.*, *Helvering* v. *Horst*, 311 U.S. 112. The fact that the money was paid to Hodge—possibly, as the Tax Court observed, in exchange for "favors" done on petitioner's behalf—did not prevent it from being income to petitioner; nor did it make the value of the "favors," rather than the "loans," the actual measure of petitioner's gain from these transactions.

2. The evidence was more than adequate to establish fraud. Petitioner's conduct with respect to Melvin's books and records demonstrated that he was deliberately concealing the nature of Melvin's profit. In addition, the payments to Hodge were falsely reflected on Melvin's books as "loans," although there appears to have been little intention to make repayment to Melvin (Tr. 447-450, 468-469, 646-655, 705-711; Exs. K, L, W, A, D, A, E, A-J).

3. There is no merit to petitioner's contention that his wife, who was not shown to have been personally involved in any fraud, may not be [illegible]

fraud penalty (Pet. 19–20). Since she signed the joint return she is subject to the joint and several liability imposed by the statute. *Ginsberg's Estate* v. *Commissioner*, 271 F. 2d 511 (C.A. 5); *Farnish* v. *Commissioner*, 262 F. 2d 727 (C.A. 9); *Prokop* v. *Commissioner*, 254 F. 2d 544 (C.A. 7); *Kann* v. *Commissioner*, 210 F. 2d 247 (C.A. 3), certiorari denied, 347 U.S. 967; *Boyett* v. *Commissioner*, 204 F. 2d 205 (C.A. 5); *Howell* v. *Commissioner*, 175 F. 2d 240 (C.A. 6). *Cirillo* v. *Commissioner*, 314 F. 2d 478 (C.A. 3), cited by petitioner (Pet. 20), is inapposite. There the wife was not subject to the imposition of the fraud penalty because she did not sign a timely joint return. The fraud consisted of the failure to file a timely return.

4. In denying petitioner's motion for rehearing (Tr. 1039)—an action which the court of appeals sustained (Pet. 7a–8a)—the Tax Court acted well within its authority. The grant or denial of a motion for rehearing is within the sound discretion of the Tax Court. *ABC Realty Co.* v. *Commissioner*, 295 F. 2d 98 (C.A. 8); *Traum* v. *Commissioner*, 237 F. 2d 277 (C.A. 7); *Leaton* v. *Commissioner*, 237 F. 2d 5 (C.A. 7). Having found that petitioner was to "be the ultimate recipient" of the money paid to Hodge irrespective of whether these payments "were intended as a payoff or as loans" (R. 111–112), the Tax Court could legitimately conclude that Hodge's testimony could not affect the result it reached.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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